

COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE OFFICE FOR ADMINISTRATION & FINANCE

Criteria for Municipal Issuance of Pension Obligation Bonds

June 23, 2006

Enacted and pending legislation regarding the use of pension obligation bonds in a number of communities states that such bonds may be issued only if, at a minimum, a comprehensive plan is first approved by the Secretary of Administration and Finance. The secretary will review each such request for approval in light of the specific circumstances surrounding the request and will in each case make his determination based on what will best serve the public interest. To help relevant municipalities evaluate their plans to issue pension obligation bonds and prepare their submission of approval requests, the Executive Office for Administration and Finance (A&F) is issuing the following guidelines.

1. Required Evidence of Recognition of Risk Prior to Seeking Approval from the Executive Office for Administration and Finance

- a. The local appropriating authority of the city or town must approve the issuance of pension obligation bonds by a two-thirds vote;
- b. In any community which has approved the issuance of a pension obligation bond prior to June 26, 2006, the following disclosure language must be accepted by a two-thirds vote, in a town, by the board of selectmen; in a city, by the council with the mayor's approval when required by law; and in a municipality having a town council form of government, by the town council:

THE USE OF PENSION OBLIGATION BONDS MAY INCREASE THE POTENTIAL LOSSES ASSOCIATED WITH PENSION FUND INVESTMENTS. THE COMMONWEALTH IS NOT RESPONSIBLE FOR ANY LOSSES INCURRED BY A MUNICIPALITY DUE TO THE ISSUANCE OF PENSION OBLIGATION BONDS, OR FOR ANY INCREASE IN UNFUNDED ACTUARIAL ACCRUED LIABILITY DUE TO DEFICIENT INVESTMENT RETURNS.

- c. Beginning June 26, 2006, the order authorizing the issuance of a pension obligation bond shall include the language in section 1(a) immediately above.

2. Approval by the Executive Office for Administration and Finance

- a. With regard to cities and towns with credit ratings of "Aa3/AA-" or higher, A&F will ascertain to its satisfaction that:
 - i. Credit Ratings
 - a) The city or town is rated by at least two nationally recognized rating agencies;
 - b) The city or town's credit rating will not decline below the "Aa3/AA-" category as a result of the issuance of pension obligation bonds.

- ii. Pension Obligation Bond Structuring
 - a) The pension obligation bonds will have a final maturity no later than 2028;
 - b) The debt service associated with the pension obligation bonds for the first three fiscal years subsequent to their issuance will be at least equal to the minimum payments required by an amortization schedule that fully funds the unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year.
 - iii. Present Value Savings
 - a) A pension obligation bond issue is projected to generate net present value savings of at least 4%;
 - b) Present value cash flow savings will be measured as the difference between debt service payments for the pension obligation bonds and the payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year;
 - c) The discount rate will be the all-in true interest cost of the pension; obligation bond issue, including all premiums, discounts, fees, insurance cost and other expenses.
 - iv. Pension Fund Management – Proceeds of a pension obligation bond must be managed by the Pension Reserves Investment Management board. A city or town seeking approval to issue a pension obligation bond will be required to obtain its local or regional retirement system's agreement to invest pension obligation bond proceeds in the Pension Reserves Investment Trust Core Fund until the bonds are no longer outstanding.
- b. With regard to cities or towns with credit ratings lower than "Aa3/AA-", but not lower than "Baa1/BBB+", A&F will ascertain to its satisfaction that:
- i. Credit Ratings
 - a) The city or town is rated by at least two nationally recognized investor rating agencies;
 - b) The city or town's credit rating will not decline as a result of the issuance of pension obligation bonds.
 - ii. Pension Obligation Bond Structuring
 - a) The pension obligation bonds will have a final maturity no later than 2028;
 - b) The debt service associated with the pension obligation bonds for the first five fiscal years subsequent to their issuance will be at least equal to the minimum payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds

unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year.

iii. Present Value Savings

- a) A pension obligation bond issue is projected to generate net present value savings of at least 4%;
- b) Present value cash flow savings will be measured as the difference between debt service payments for the pension obligation bonds and the payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year;
- c) The discount rate will be the all-in true interest cost of the pension obligation bond issue, including all premiums, discounts, fees, insurance cost and other expenses.

iv. Financial Capacity and Reserves

- a) At least 25% of annual cash flow savings realized from issuing a pension obligation bond shall be placed in a reserve account which, until the pension obligation debt has been retired, shall be used only to pay any additional assessments from the retirement system attributable to an investment return shortfall (compared to the actuarial assumed investment return) on pension obligation bond proceeds.
- b) A city or town must possess the financial capacity to address additional unfunded liabilities that may arise should returns on pension assets be below the assumed rate of return. A&F's analysis will include, but not be limited to, the following:
 - tax levy capacity
 - reserves
 - debt levels
 - management

- v. Pension Fund Management – Proceeds of a pension obligation bond must be managed by the Pension Reserves Investment Management board. A city or town seeking approval to issue a pension obligation bond will be required to obtain its local or regional retirement system's agreement to invest pension obligation bond proceeds in the Pension Reserves Investment Trust Core Fund until the bonds are no longer outstanding.

- c. City or towns with credit ratings at or below “Baa2/BBB” will not receive approval from A&F to issue pension obligation bonds.

3. Subsequent to A&F Approval:

- a. The city or town must provide A&F with the value of its pension fund on a “mark-to-market” basis no earlier than 60 days prior to the issuance of pension obligation bonds;

- b. The city or town will conduct an actuarial valuation of its pension assets once every year and report its findings to both A&F and PERAC. If the actuarial valuation of pension assets is less than projected pension liabilities, the city or town must fund this deficiency based upon a PERAC approved schedule.

4. General Provisions

Notwithstanding any provision herein to the contrary, A&F reserves the right to disapprove any request for the issuance of pension obligation bonds. A&F further reserves the right to require the submission of any materials or information it deems necessary for its determination or to waive any requirement listed above.